37

Massachusetts Bankers Association

November 28, 2000

Manager, Dissemination Branch
Information and Management Services Division
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552
Attention: Docket No. 2000-56, 2000-57
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Subject: Repurchases of Stock by Recently Converted Savings Associations, Mutual Holding Company Dividend Waivers, Gramm-Leach-Bliley Act Changes; Interim Rule 65 *Federal Register* (No. 134) 43088 (7/12/2000) Docket No. 2000-56

Notice of Proposed Rulemaking, Mutual Savings Associations, Mutual Holding Company Reorganizations, and Conversions From Mutual to Stock Form
65 *Federal Register* (No. 134) 43092 (7/12/2000) Docket No. 2000-57

Dear Sir/Madam:

We appreciate the opportunity to comment on the above referenced proposed rulemaking, which would implement a comprehensive strategy governing mutual institutions, mutual holding company (MHC) reorganizations, and the mutual to stock conversion process. The Massachusetts Bankers Association, which represents over 200 commercial, co-operative, and savings banks, as well as savings and loan associations with more than $350 billion in assets, commends the efforts of the Office of Thrift Supervision (OTS) to improve its supervision of mutual institutions and to enhance the viability of the mutual charter. Also, we appreciate the clarity of the Agency's "plain English" proposal.

The first United States mutual savings bank was organized in Massachusetts in the early 1800's. Many of our mutual institutions have been serving their communities for over 170 years. Today, approximately 60 percent of all Massachusetts banks are organized in mutual form, representing the largest of all states in the country. There are 120 state-chartered savings and co-operative banks organized in mutual form, 21 MHCs, as well as 14 federally chartered mutual savings associations in the Commonwealth which continue to play a significant role in providing credit, community investment, and depositor services.

We applaud the Agency's encouragement of the formation of MHCs as an alternative to full stock conversion, as well as the flexibility provided in the interim rule to expand into new business lines, merge with other institutions and compensate directors. Consistent with the Agency's goal to enhance the MHC charter, the proposal seeks to increase the number of options available to those institutions that in the past looked to conversions to facilitate expansion or diversification, raise capital and, remain competitive. We are pleased with this approach since the mutual holding company structure is increasingly being adopted in Massachusetts; however, it should be noted that historical conversion trends in Massachusetts have been much more deliberate than in other parts of the country. In fact, we would assert that most mutual banks have no intention of converting. Our principal concern is to protect against any unintended consequences resulting from these or other regulatory mandates.

The Agency should take care that its policies do not force institutions that wish to remain in a mutual form to convert to remain competitive. An important issue for mutuals will be whether the regulation of holding companies at both the state and federal level is flexible enough to permit mutuals to choose the governance form that is most suitable for their business needs and to access the stock charter when necessary. The long-standing position of our Association has been that both mutual and stock institutions have key roles to play in our financial services community in the Commonwealth, and neither state nor federal policies should be weighted to encourage one form of corporate organization over another. Therefore, the proposed regulations are particularly important to the Association and its members.

In the proposal, the OTS encourages institutions considering raising new capital to consider seriously the MHC form of reorganization with a limited stock issuance, rather than a full conversion. While it appears that the proposed regulations encourage mutuals to become MHCs, they may also limit their ability to exit from a MHC structure. This is an area of concern; institutions making a sound business decision to fully convert to stock should not be pressured by their regulator, or for that matter external activist groups, to remain a MHC or hindered from converting. Absent safety and soundness concerns, management should be provided maximum flexibility without interference to choose the best structure for their institution and community.

The proposed rule includes new provisions requiring the submission of business plans in all conversion situations, procedures and requirements for the creation of charitable organizations or the making of charitable stock contributions as a part of the conversion process. The proposed rules would also clarify certain matters relating to mutual to stock conversions, by, among other things, adding demand account holders to the definition of savings account holders; allowing accelerated vesting in management benefit plans for changes of control; specifying that a converting association must retain at least 50 percent of the conversion proceeds; and clarifying the Agency's policy on the amount of conversion proceeds allowed to be retained at the holding company level.

The proposal also sets forth certain content which a business plan would have to include, which matters it would have to address, and which standards it would have to comply. The proposal clarifies OTS' "expectation" that upon completion of a conversion, the converting institution will follow the business plan, and emphasizes that "any material deviation from an approved business plan" would require the prior written approval of the responsible OTS Regional Director. The proposal would permit savings association subsidiaries of MHCs, or HCs inserted between MHCs and their savings association subsidiaries, to offer broader management benefits or stock option plans than currently may be offered.

The interim rule positively changes the regulations governing repurchases of stock of insured savings associations—by eliminating restrictions on stock repurchases by converted savings associations after the first year following conversion (instead of the historic three years)—and allows the OTS to authorize repurchases, even during the first year, under certain circumstances. In addition, the OTS has modified its historic policy of requiring minority shareholder dilution to compensate for previously waived dividends by majority owners when the institution is converting. The interim rules codify a new policy position indicating that the OTS will "no longer require dilution for any waived dividends in a subsequent conversion to stock form." Finally, reflecting the GLBA's changes in the activity limitations for MHCs to parallel those of "financial holding companies," the Agency has incorporated the GLBA changes into its new interim rule to give MHCs parity with financial holding companies.

In general, the Association believes that the interim changes improve the attractiveness of MHC structure but the conversion proposal recreates obstacles for a full conversion and, in effect, dilutes a key advantage of the MHC structure. The Association would like to offer the following comments on questions proposed by the Agency and specifics of the proposals:

1. Policy Guidance: With respect to the development of guidance for special "dividend" payments by mutual institutions, we believe that such guidance would be akin to issuing guidance on the payment of interest to borrowers and would oppose the notion. Such guidance could have the unintended consequence of providing an implied tangible value to the ownership interests of depositors, although case law has determined otherwise. In addition, it may create an expectation that institutions should pay special dividends upon conversion; or worse, lead borrowers to force institutions to convert in expectation of a windfall distribution. In fact, since retained earnings are the only "safety net" for future capital needs, anyone who suggests that there is a potential for "too much" capital has forgotten the New England real estate crisis of the late 1980s and early 90s. Alternatively, should the Agency choose to publicly reconfirm the long-standing position in support of past legal opinions, it would be most welcomed (i.e., depositors do not own the capital of a mutual institution).

   Separately, we would welcome policy guidance that focuses on various capital-raising alternatives, such as the use of subordinated debt instruments, mutual capital certificates, non-withdrawable accounts, trust preferred securities, and other financing transactions provided mutual institutions are not burdened with demonstrating why its management selected one alternative over another.

2. Pre-Filing Meeting and Business Plans: The proposed rule establishes a new requirement for a pre-filing meeting with the Regional Office prior to the acceptance of a formal business plan and commencement of a 30-day business plan review period. While the Association agrees that the pre-filing meeting may be useful to ensure that the board of directors has fully considered the costs and benefits of conversion and the available alternatives, we are concerned that an additional approval process could greatly extend an already lengthy process. We believe that the Agency's current ability to review the business plan as part of the conversion process would provide the most efficient means of facilitating the process. At a minimum, should the Agency pursue a pre-filing meeting, it should be informal, not adding another layer of approval to the conversion application process.

3. Return on Equity (ROE): The proposed regulations would require that an institution planning to convert from mutual to stock demonstrate its ability to realize a minimum return on equity in its business plan that exceeds by a margin reflecting relative investment risk, the institution's rates on long-term certificates of deposit. Under the proposal, converting institutions may not consider speculative short-term stock price appreciation, or the effect of returns of capital or repurchases of stock, in assessing the reasonableness of projected return on equity, even though these may indeed be factors considered by investors.

   The proposed standards represent a sharp departure from past policy establishing criteria that cannot be realistically met. Historically, mutuals that have converted to stock successfully increased the equity of stock savings institutions and deployed capital over a period of time. Initially, ROE levels decline because newly converted banks must deploy new capital in a safe

and sound fashion. Empirical evidence demonstrates that after a period of time (more than three years), ROE levels return to or exceed historical levels after capital has been successfully deployed. In support of our view, we would comment that the market does not require a market level ROE upon conversion or completion of an IPO. Thus, the proposed requirement would place extraordinarily high standards on a thrift's stock performance. For this reason, implementation of the business plan must be allowed reasonable time for the market returns to reach even modest levels of ROE. Otherwise, if the standard is unreasonable it will create a tremendous hurdle to full stock conversions of mutual holding companies and undermines the benefit of the MHC form. Another consequence may result in the market devaluation of existing MHC stock further limiting the stock liquidity and competitiveness of small savings institutions considering the MHC structure.

We support the view that ROE is an important factor in determining the potential success of a conversion, but it is not the only factor. The Association strongly urges consideration of total return on investment as another indicator of success. A converting institution should be able to include in its business plan the effect of returns of capital and/or repurchases of stock, in assessing the reasonableness of projected return on equity. These are important capital management tools that have been used successfully by all stock institutions to improve their ROE and return on shareholder investment.

4. Affiliations with other Mutuals: We believe that a federally chartered mutual institution should be permitted to affiliate with other institutions to leverage managerial and administrative resources. In June 2000, Massachusetts enacted Chapter 46 of the Acts of 2000, which repeals the provision prohibiting state-chartered banks or a state and federally chartered bank from sharing the same office. In addition, it authorizes an independent bank to act as agent for another bank to provide customer services. To the extent possible, the OTS should use its authority to create similar efficiencies for federally chartered mutual institutions.

5. Charitable Organizations: The Association agrees with the codification of the standards and procedures for creating charitable foundations upon conversion. Massachusetts banks have been utilizing charitable foundations as a means of investing in its community for some time.

6. Shareholder Vote on Stock Benefit Plans: We urge the Agency not to adopt a different policy for stock benefit plans than that which currently exists for other publicly listed companies. To do so would continue to exacerbate the dichotomy of how banks are viewed by the financial community/Wall Street vs. non-bank financial services companies.

Community activists who perceive a "something for nothing" opportunity may feel differently about this portion of the proposal. In response to their expected criticism, let me reiterate our long-standing position that proposals regarding expropriating part of the conversion proceeds for community development projects or other local needs seem to assume that these are public funds, which they are not. A bank planning an acquisition or an expansion should not have its newly raised capital subjected to a 'social tax' any more than any other public company during an IPO. Such a confiscation of capital not only jeopardizes the safety and soundness of the bank and the insurance fund but exacerbates credit availability to local consumers and small business. In addition, we would assert that suggestions inferring that a bank's planned contributions to or investments in the community must be reviewed prior to conversion approval must be resoundingly refuted. While the conversion proceeds will enhance the

bank's ability to meet its CRA obligations, mutual-to-stock conversions should not be singled out for an additional CRA commitment or diversion of funds. These institutions should be evaluated during the next compliance exam and not have their conversion made contingent upon pledges for future community investments.

Finally, as an Association that represents a significant number of state-chartered mutual institutions regulated by the Federal Deposit Insurance Corporation (FDIC), we urge the Agency to ensure that its regulations are consistent with the FDIC and do not create any disparities between federal regulatory agencies. Thank you for taking the time to review these comments, if you have any questions, please call me at (617) 523-7595.

Sincerely,

Tanya M. Duncan

Tanya M. Duncan
Director, Federal Regulatory and
Legislative Policy

TMD
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